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ABSTRACT

This report discusses recent changes in federal aid to postsecondary students enacted by Congress during 1992-93, focusing on the 1992 Amendments to the Higher Education Act and the 1993 Federal Direct Student Loan (DL) Program. The report reviews recent issues surrounding federal aid to postsecondary students, such as program accountability and simplification, and discusses the various types of grants, loans, and national service programs available to students. It then discusses the changes made to various federal aid programs in the areas of institutional eligibility, default rates, and need analysis. Specific changes in the Pell Grant and Guaranteed Student Loan Programs (now called the Federal Family Education Loan Program) are then examined, including unsubsidized loans, loan limits, interest rates and fees, cost saving and risk sharing, repayment options, and consolidation loans. The report then discusses the DL program, outlining the phase-in period, eligibility, repayment options, and administrative costs of the new program. (MDM)

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94-10 EPW

ED 378 876

CRS Report for Congress

Recent Changes in Federal Student Aid

Margot A. Schenet
Specialist in Social Legislation
Education and Public Welfare Division

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RECENT CHANGES IN FEDERAL STUDENT AID

SUMMARY

Introduction

The Federal effort to assist low- and moderate-income students attain a postsecondary education was initiated in the Higher Education Act of 1965 (HEA) and continues to be sustained through subsequent amendments to HEA. Title IV, the heart of the Act, authorizes four types of student aid--grants, loans, work study, and fellowships. Considerable legislative activity concerning student aid occurred during the 102d Congress and the first session of the 103d. After extensive hearings and debate, the 1992 Amendments to the Higher Education Act were signed into law on July 23, 1992 (P.L. 102-325). Technical amendments to the 1992 amendments and to the HEA were passed prior to the end of the first session of the 103d Congress. In addition, in this Congress, the Clinton Administration proposed a major change in the delivery of Federal student loans by converting the guaranteed student loan programs, called Federal Family Education Loans, into direct loans. Debate over a similar proposal had led to the inclusion of a pilot program in the 1992 HEA reauthorization. The final version of the direct loan program was enacted as part of the Omnibus Budget Reconciliation Act of 1993, P.L. 103-66.

Issues

A number of significant issues were raised during debate over reauthorization of the HEA and continued during consideration of the Clinton Administration proposals. These issues included the following: how to improve program integrity, and especially, increase institutional accountability in the student aid programs, without interfering with traditional institutional autonomy in the postsecondary sector; how to reduce the complexity and simplify the student aid application process without reducing student access to State and institutional aid; how to shift the balance between grant and loan aid or restructure the aid programs to increase assistance without increasing Federal costs; and how to provide additional aid to middle income students to increase their choice of postsecondary institutions, while at the same time, finding new ways to improve the postsecondary attendance rates for low income and minority students.

Legislative Changes

Legislation in the 102d Congress and the first session of the 103d made major changes in student aid in efforts to deal with these issues. These changes included: reform of the structure and standards by which postsecondary education institutions become eligible to participate in the student aid programs authorized under title IV of the HEA; simplification of the need analysis formulae and application forms and procedures for determining a student's financial need for student assistance; amendments to the award rules and maximum award authorized in the Pell Grant program; alteration of the terms of loans and eligibility for the guaranteed student loan programs; creation of a new Federal direct loan program, scheduled to replace at least 60 percent of new student loan volume by academic year 1998-1999; and, creation of new programs to encourage and support postsecondary attendance by disadvantaged students.

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RECENT CHANGES IN FEDERAL STUDENT AID

INTRODUCTION

The Federal effort to assist low- and moderate-income students attain a postsecondary education was initiated in the Higher Education Act of 1965 (HEA) and continues to be sustained through subsequent amendments to HEA. Title IV, the heart of the Act, authorizes four types of student aid--grants, loans, work study, and fellowships. Most of these student aid programs require recipients to pass a financial need test to determine a student's and his or her family's ability to pay for the course of study. In academic year 1991-1992, U.S. Department of Education (ED) programs provided over $20 billion in student aid to help nearly 6 million students meet the costs of postsecondary education. Such aid can be used for attendance at over 8,000 federally eligible institutions, public and private, profit and nonprofit, including traditional colleges and universities, community or junior colleges, and vocational/technical career schools.

The postsecondary universe has changed significantly since the passage of HEA in 1965. Several underlying trends that developed in the 1980s have played an important role in policy deliberations on the Federal role in postsecondary education, and particularly on student aid programs. These are the continuing increases in college costs, the increase in the number and proportion of "nontraditional" students--those who go to school part-time, live independently of their parents or are over 24 years old--attending postsecondary education, and the growth in the participation of students attending proprietary vocational schools.

The College Board estimates that the annual cost of attendance (tuition and fees, room and board) for a full-time student during academic year 1991-1992 was an average of $5,320 at a public 4-year school and $12,866 at a private 4-year institution, in constant 1991 dollars. This compares to $4,210 at a public 4-year school and $9,228 at a private 4-year school in the 1982-83 academic year, in 1991 dollars. Selective private universities may cost considerably more, while 2-year community colleges cost much less. College costs have been increasing at an annual rate of between 5 percent and 8 percent over the last few years, increases that have consistently outpaced inflation.

There is a growing realization that large numbers of "nontraditional" students attend postsecondary institutions. Indeed, the traditional route directly from high school to 4 years in college is becoming unusual at some institutions where students who might be considered "nontraditional" make up half or more of the student body. Nontraditional can mean many things and there is considerable overlap between students who exhibit one of the criteria: independence, part-time attendance, older than 24 years of age. Data collected by the ED in 1986 indicate that of 11 million undergraduates enrolled in the fall, over 4 million were either independent of their

parents for financial support, attended school part-time, or were 24 years old or older.

A third trend has been an increase in the proportion of student aid that goes to proprietary school students. Proprietary schools are privately owned postsecondary institutions operated for profit to provide vocational education and training. Generally, proprietary schools offer training for jobs in trade and technical fields, cosmetology, and business. Program length can vary from a few weeks to 2 or more years, but most programs are less than 2 years in duration. The proportion of federal student loan volume borrowed by proprietary school students increased almost 5-fold during the 1980s. Federal grant awards to the sector doubled in the 1980s. Today, total title IV aid to proprietary school students equals more than $5 billion.

Considerable legislative activity concerning student aid occurred during the 102d Congress and the first session of the 103d. The HEA was scheduled to expire in the 102d Congress. After extensive hearings and congressional debate, the 1992 Amendments to the HEA were signed into law on July 23, 1992 (P.L. 102-325). Technical amendments to the 1992 amendments and to the HEA were passed prior to the end of the 1st session of the 103d Congress. In addition, and more importantly, in this Congress, the Clinton Administration proposed a major change in the delivery of Federal student loans by converting the guaranteed student loan programs, called Federal Family Education Loans (FFEL), into direct loans. Debate over a similar proposal had led to the inclusion of a pilot program in the 1992 HEA reauthorization. Offered as part of the Omnibus Budget Reconciliation Act of 1993 (OBRA 93), the final version of the direct loan program, as enacted in the reconciliation legislation, P.L. 103-66, provides for a direct loan phase-in through the 1998-99 academic year. Although during the campaign President Clinton had linked the direct loan proposal with a new program of national service, the national service legislation, P. L. 103-82, was enacted separately, and, at least from the congressional sponsors' perspective, was viewed primarily within the rubric of social service programs rather than student aid.

This paper reviews the issues that were raised during debate over reauthorization of the HEA and continued during consideration of the Clinton Administration proposals. It summarizes the major changes to student aid resulting from the legislation listed above. More detailed analyses of many of these changes and specific programs can be found in the Congressional Research Service (CRS) reports listed in the bibliography at the end of this paper. (Earlier versions of some sections of this report were written by Charlotte Fraas and Jim Stedman.)

RECENT ISSUES

Program Integrity/Accountability

Increases in the default rate in the guaranteed student loan programs during the 1980s led to a focus on student aid program integrity and the extent to which fraudulent or abusive actions by schools or other program participants may be

contributing to defaults. In the late 1980s, ED's Office of Inspector General (OIG) identified title IV student aid programs as vulnerable to fraud and abuse and devoted substantial resources to audits and investigations of program participants and their oversight by ED. The Senate Permanent Subcommittee on Investigations, chaired by Senator Sam Nunn, held a series of hearings in the 101st Congress on student aid program abuses, and issued a report in May 1991 finding that the Guaranteed Student Loan (GSL) program was "plagued by fraud and abuse at every level . . . ." Even more recently, the same subcommittee conducted hearings on the Pell Grant program (the largest title IV grant program and considered the foundation of Federal student aid). The subcommittee staff testified to finding a "similar pattern of abuse" in the Pell Grant program.

The GSL program default rate and default costs have been at an all-time high, and some attributed this condition in part to the exploitation of the loan programs by certain program players seeking high profits from the billions in loans disbursed to students annually. Media attention has been focused on for-profit trade schools as a major source of program abuse, because their student default rates are at least one-and-one-half times those of other postsecondary institutions. The charge is that such schools exploit the ready availability of loans and other student aid to lure students into their programs. Subsequently, the students are not equipped to support loan repayments and suffer the consequences of default. Schools claim they serve disproportionately high numbers of students at-risk of default.

During reauthorization of the HEA in the 102d Congress, attention focused on how to improve the regulatory structure to assure probity among program participants, in particular the current "triad" structure used to approve schools for program participation. The triad consists of accreditation by private accrediting agencies, approval or licensure by a State agency, and certification by ED. Would the triad be a more effective approval mechanism if greater reliance were placed on strengthened State and accrediting agency oversight? Were stricter standards for ED certification also needed? As an alternative to changing the general structure for institutional eligibility, should the laws and regulations be applied differently to certain schools (defined by institutional sector, or some indicator such as default rates) to deal with integrity issues? Although significant changes have been made in the procedures for institutional eligibility, continuing issues include the extent to which institutional default rates are an appropriate measure of institutional probity; their use as a gate-keeping mechanism for Federal student aid programs; and whether additional measures of institutional accountability and program outcomes can and/or should be developed for use in Federal policy.

Simplification

Prior to reauthorization, concerns were raised that the Federal student aid application process had become increasingly complex and was itself creating barriers to an equitable student aid delivery system. The HEA included two separate formulas for assessing the extent to which families could contribute to the costs of a student's education, resulting in different "expected family contribution" amounts for the Pell

Grant program and the rest of title IV aid. These need analysis formulas used information about the student and his or her family's income and assets to determine the amount that the family could reasonably be expected to contribute to paying for the cost of attendance at a postsecondary institution. Students were required to provide the financial and other information to be used in the formula as part of the application process. In addition, separate forms were required for the student loan programs, with little standardization across the multitude of participants. Although ED was required to develop a free common financial reporting form for students to use in applying for title IV aid, and applicants were not to be charged for processing these data, the free Federal application form was only one of six different forms students might use to apply for title IV student financial assistance. The other application forms in use frequently supplemented the federally required data with additional questions needed to determine eligibility for State and institutional aid. Students wishing to apply for other aid and filling out the additional information were charged a fee by contractors receiving ED reimbursement for processing the federally required data.

In attempting to reduce the complexity of the application process and of the underlying formulas for determining financial need, policymakers grappled with how to promote a free application for Federal aid, when other aid providers continue to require additional data, whether most of the financial information currently required could be bypassed for the poorest applicants (and how to define that group), how to make the application questions simpler for all, and which of the current need analysis formulas in the law to use as the basis for a single integrated formula. Despite significant progress in reducing the complexity of the application process and integrating the need analysis formulas during reauthorization, simplification efforts continue with further standardization and the need to deal with the continued proliferation of programs.

Types of Assistance

Balance between Loans and Grants

The balance between Federal student loans and grant assistance has been another area of concern. During the 1980s, loans replaced grants as the major source of Federal student aid, at the same time that aid eligibility was increasingly focused on lower-income students. This shift is the consequence of the recent period of tight Federal budgets and spiralling college costs. According to the College Board, in the mid-1970s about 76 percent of Federal student aid was awarded in **grants**, 20 percent in loans and 3 percent in work-study aid; in the 1987-1988 academic year, about 67 percent of Federal student aid was awarded in **loans,** 29 percent in grants and 3 percent in work-study (percents are rounded). As a result, many students incur considerable debt to attend college, and loan default costs to the Federal Government have grown. Some policymakers have been concerned about the consequences of this situation: high student debt levels, and rising default costs. Some argued that loans and the subsequent debt are unacceptable to some students, particularly disadvantaged and minority students for whom the aid was intended, which may result in decisions

to forgo postsecondary education. Others pointed out that low family income is correlated with a student's proclivity to default on a student loan and have been concerned that high Federal default costs are implied by the current policy. Further, the cost of default to the students themselves is considerable: they incur a bad credit rating as well as ineligibility for any future student aid. On the other hand, loans continued to be supported as a primary source of student aid because of the ability to leverage additional funds, clearly an important feature in the current fiscal climate.

The major Federal grant program, Pell Grants, on the other hand, unlike the guaranteed loan program which is an entitlement, is a discretionary program. That is, the award levels are dependent on appropriations. To insure that everyone eligible gets the grant for which they qualify. appropriators reduce the level of the maximum award to fit the available appropriations. (This is based on estimates made by the ED of the appropriations needed to fund a given maximum award level; when those estimates are in error, ED "borrows" from the following year's appropriations, resulting in what is termed the Pell Grant program "shortfall.") In the current fiscal climate, this has meant that increases in the authorized maximum have not been funded during the appropriations process. During reauthorization, original bills in both the House and the Senate contained provisions to make the Pell Grant program an entitlement with a significantly increased maximum. This would have allowed shifting the balance back in favor of grant aid. However, these provisions were opposed and eventually eliminated from the legislation because of failure to conform to the "pay-as-you-go" provisions for direct spending (entitlements) under the Budget Enforcement Act of 1990 (P.L. 101-508). Subsequently, the substantial increase in the authorized maximum grant was not funded during the appropriations process, and the grant/loan imbalance remains a concern.

Direct vs. Guaranteed Loans

The Guaranteed Student Loan (GSL) programs (renamed the Federal Family Education Loan (FFEL) programs in the 1992 amendments) provide the majority of Federal aid available for postsecondary students to attend colleges, universities and trade and technical schools. Several different types of loans are available to support student expenses: subsidized or unsubsidized loans for undergraduate and graduate students; loans for parents of dependent students, and consolidated loans.

The guaranteed student loan system is complex largely due to the number of participants involved in the origination and servicing of the loans. FFEL loans are made by some 7,800 private lenders using their own capital. These lenders are insured against loss through borrower default, death, disability, and bankruptcy by guaranty agencies. In addition, lenders are assured a minimum rate of return, given market conditions, through a "special allowance" payment to supplement the borrower's interest.

The guaranty agencies operate under an agreement with the Federal Government, which reinsures these agencies by reimbursing them for default claims they pay lenders. In turn, the guaranty agencies administer much of the FFEL programs. A

secondary market provides liquidity to lenders through buying their FFELs or lending them money to make more loans. The largest secondary market entity is the Student Loan Marketing Association (Sallie Mae), which is a Government Sponsored Enterprise (GSE--a private corporation chartered under Federal law to serve a public purpose) founded in 1972 specifically to purchase student loans.

The Federal Government will pay an estimated 11 cents for each FFEL dollar loaned in FY 1993. Major costs include reinsurance payments it makes to guaranty agencies for defaults, and paying interest for needy students while they are in school and during grace and deferment periods. Special allowance payments are not a Federal cost currently, but could become significant if interest rates rise. Federal costs are partially offset by collections on defaulted loans and other Federal receipts, including origination and reinsurance fees. Federal costs for FFELs are entitlements.

Given the current complexity and costs of the guaranteed student loan programs, direct loans became the focus of interest as an alternative during debate on the reauthorization of the HEA. In a general sense, direct loans are loans made with Federal capital and owned by the Federal Government: the Federal Government is effectively the banker. Postsecondary schools would act as the originator of the loan on behalf of the Federal Government, with subsequent servicing by Federal contractors or, possibly, the U.S. Internal Revenue Service (IRS).

Direct loan supporters contended that the existing guaranteed loan system, with its middleman players, was unnecessarily costly and complex and that direct loans could save the Government billions of dollars because the Federal cost of delivering loans to students directly would be lower than subsidy costs necessary for the Federal Government to provide student loans through private lenders under the existing system. Related program savings could be passed on to students through reduced student interest rates or fees. Supporters also argued that a direct loan program would simplify loan delivery and servicing for students, and enhance program oversight because the complex web of guaranty agencies, banks and secondary markets would be eliminated under direct lending.

Opponents of direct lending questioned the accuracy of comparative cost projections showing significant budget savings, as well as being concerned about increases to the Federal debt that would be caused by the Government capitalizing some $20-25 billion in direct loans annually. They also questioned the capability of the Department of Education (ED) to manage a direct loan program, especially in light of consistent recent criticism from the General Accounting Office (GAO), the ED Inspector General, and the Office of Management and Budget (OMB) for its mismanagement of the FFEL and other student aid programs. Concerns were also expressed about student access to credit during a transition period. Despite the passage of a direct loan program in OBRA 93, many of these concerns continue to exist as implementation and the transition begins.

National Service

As originally proposed by the Clinton Administration, the national service initiative was combined with reforms to the loan programs and, at least rhetorically, suggested a major restructuring of student aid to focus on rewards for service rather than financial need as the basic mechanism for awarding aid. As considered by Congress, the National and Community Service Trust Act of 1993 established a program of service opportunities that includes as one component a postservice educational award that can be used to pay for postsecondary education and training or to repay student loans, but does not fundamentally alter the student aid programs in title IV of the HEA. Further details on the new national service program as passed are not discussed in this report, but can be found in *National Service: Issues and Legislation in the 103d Congress*, CRS Issue Brief No. IB93055, by Dale Robinson.

Access and Choice

Aid for the Middle Class

With college costs outpacing inflation, concern has grown about the limited access middle-income families have to student aid programs. Such families, some argued, were being squeezed out of postsecondary options: low-income students are eligible for Federal aid, often supplemented by State or institutional aid for attendance at high-cost private institutions; students from high-income families can either pay outright for college expenses or have access to private loan programs because of their low credit risk. Lacking access to student aid--even low-cost loans--middle-income students may have limited **choice** in the postsecondary spectrum. They can either attend lower-cost public institutions or shorter term programs.

Middle class access to student aid programs has eroded over the years with greater pressures to control Federal spending. Originally, for example, the GSL program was created as the aid source for middle class families. In the 1980s student aid eligibility shifted to low-income students, particularly by the provision of 1986 amendments to the HEA requiring a financial need test for all GSL applicants. With this background, many believed that continuing to exclude the middle class from student aid programs was politically unacceptable. However, it was also clear that relaxing the need requirements in the loan programs or revising the need analysis formula to exclude certain assets for middle-class families could imply a significant increase in loan volume with an accompanying increase in program costs. Nevertheless, changes in the need analysis formula and the creation of a new loan program open to all regardless of financial need were enacted as part of the HEA reauthorization.

Access for Disadvantaged Students

From its inception, a central purpose of HEA has been to facilitate access of disadvantaged (low-income and minority) students to postsecondary education opportunities. Each time the HEA has been reauthorized, debate has included

consideration of HEA's role in facilitating college enrollment by populations finding it difficult or impossible to attend. The reauthorization effort by the 102d Congress was no exception. Although enrollment trends have sparked concern about college access, the messages from those trends are complex and, at times, ambiguous. Since the mid 1970s, minorities in general have **increased** their share of total higher education enrollment, although different minority groups have had different experiences. Of particular concern to many observers, however, was that, despite rising numbers, the college enrollment **rates** for black and Hispanic 18 to 24 year olds are less than the rate for whites. Between 1976 and 1990, the gap between black and white enrollment rates grew by more than half; while the Hispanic-white gap more than doubled.

Family income also continues to be strongly associated with college enrollment, despite the goal of HEA to eliminate financial barriers to postsecondary attendance. In general, students with low family income still are less likely to be enrolled in college than are students from families with higher incomes. Low-income and minority access questions are clearly confounded, since minority status is associated with low income. Access problems and policy responses affecting one group may have an impact on the other.

Thus, during reauthorization of the HEA, proposals were made to improve the attendance rates for low-income and minority students. One promising avenue receiving attention was early intervention programs. These programs, both privately sponsored and State supported, are intended to improve disadvantaged youth's chances of finishing high school and enrolling in college by providing specific incentives, such as promising college scholarship aid to participants who complete high school, and providing academic and social assistance during the secondary school years. Perhaps the most widely known of the private efforts is that initiated by Eugene M. Lang in New York City and now supported there and elsewhere by his I Have A Dream Foundation. A number of States, including New York, Louisiana, and Rhode Island, have initiated similar efforts, and as a result, the 1992 HEA amendments enacted several new programs to encourage and support these efforts through the HEA.

CHANGES IN STUDENT AID

Institutional Eligibility

In an effort to deal with concerns raised by reports of fraud and abuse and to strengthen program integrity, the 1992 HEA Amendments, as further amended by the Technical Amendments of 1993, revised the definitions of eligible institutions and included a number of provisions to reform the process by which institutions become eligible to participate in title IV student aid programs. Although the amendments generally elected to reform the institutional eligibility rules for all postsecondary institutions, the changes are likely to have the greatest impact on the proprietary school sector.

The 1992 amendments revised the institutional definitions in title IV to stem alleged abuses relating to the participation of foreign schools in the GSL programs, the eligibility of less than 600 clock hour programs for GSL funds, and eligibility for institutions providing correspondence programs. Under previous law, foreign schools and foreign medical schools were eligible for participation in the GSL programs only. Rather than eliminating these institutions from participation because of concerns about the quality of their programs and the inability of ED to provide oversight, the amendments allow students who attend schools outside the United States to receive FFEL loans, but with somewhat more stringent requirements for the institutions.

The predominantly vocational programs of 300 to 600 clock hours that were also eligible only for loan program participation had been the focus of much of the attention in charges of fraud and abuse and high default rates. As amended, such programs that require at least an associate degree for admission are now eligible for participation in all title IV programs, while other 300 hour programs are eligible only for guaranteed student loans **if** the Secretary determines they have verified 70 percent completion and placement rates.

As amended, HEA now excludes from eligibility any institution that offers more than 50 percent of its courses by correspondence or enrolls more than 50 percent of its students in such courses; distinguishes between correspondence and telecommunications as modes of instruction; and provides that students can receive assistance for correspondence courses only if such courses lead to a degree.

Two provisions in the 1992 amendments singled out the vocational or proprietary school sector with respect to eligibility. Proprietary institutions must have at least 15 percent of revenues from non-title IV sources to be eligible, and non-degree granting institutions cannot enroll more than 50 percent of their students without a high school degree or equivalent.

The amendments established a new Part H of title IV of the HEA that attempts to strengthen each component of the triad: State review, accreditation, and ED's eligibility and certification procedures. Under the State postsecondary review program, States sign agreements with the Secretary designating a single entity to coordinate and represent all authorizing agencies in the State. These State entities will review institutions for purposes of title IV eligibility for which they will be reimbursed by ED. To avoid problems with claims of State interference in the affairs of traditionally independent public or private colleges and universities, the Secretary of ED will identify institutions according to criteria that include high default rates, overreliance on Federal aid, a pattern of student complaints, exceptional fluctuation in title IV revenues, and initial participation in any title IV assistance program (public institutions affiliated with a State system of higher education are exempt from the last criterion). According to ED, over 4,000 institutions are subject to review by State entities under these criteria.

These institutions will then be reviewed by the State entity in accordance with State standards in specified areas including the quality of the instruction and personnel as determined through an external peer review or accreditation process, student consumer protection, financial and administrative capacity, the relation of student charges to the expected employment outcomes, and program outcome criteria, such as graduation and placement rates. While this State review process is separate from current State licensing activities, the requirement for review of new institutions will presumably lead to coordination between these activities.

The accreditation process is also strengthened in the new part H, which establishes in statute criteria for ED recognition of accrediting agencies, including that they be required to consider title IV administration and financial data in reviewing schools. Special requirements were added to insure that proprietary school accrediting bodies are separate and independent, both administratively and financially, from the industry trade associations.

Finally, the new part H also significantly strengthens the Federal requirements for eligibility and certification. Among the key provisions are a Federal prorata refund requirement for all institutions (for first time students who withdraw before completing more than 60 percent of the program); a requirement that all currently certified institutions be recertified within 5 years with priority for troubled institutions including those that meet the criteria for State review; a 4 year limit on certification with provisional certification for troubled institutions; and on-site review by ED prior to initial or re-certification. Branches are to be treated as separate institutions for purposes of eligibility and certification (with the exception that they would not be required to be in existence for 2 years prior to being certified), as would schools that change ownership with some exceptions.

With respect to financial responsibility determinations, the new part H requires annual compliance audits and annual audits of the institution's financial condition in its entirety; the establishment of new financial responsibility standards to be based on audited financial statements prepared by certified public accountants; and a requirement for financial guarantees and the assumption of personal liability by the owner or individuals with substantial control sufficient to cover potential liabilities for Federal funds for institutions that do not meet new financial responsibility standards.

Cohort Default Rates

The 1992 amendments retained previously enacted default control provisions that limit the eligibility of institutions to participate in the student loan programs in part B of title IV based on high default rates with the threshold being 30 percent for FY 1993 and 25 percent for FY 1994 and subsequent years. Efforts to extend the use of these cohort default rates as a criterion for continued participation in any title IV program were not successful. However, the 1993 reconciliation legislation extended the use of default rates as a means to encourage States to monitor their schools: under this provision, States are required to pay a fee to the Secretary of ED based on the new loan volume attributable to schools in the State with cohort default rates

exceeding 20 percent. Because of numerous complaints and some court cases that challenged the quality and meaning of the data on which ED based determinations of school default rates and ultimate exclusion from the loan programs, the 1993 Higher Education Technical Amendments clarify the right of institutions to review data ED uses to calculate the rates. They provide that institutions may appeal on grounds of improper loan servicing, and the Department must insure that schools have access to a representative sample of data records for a reasonable time period.

Need Analysis

To improve the student aid application process, the 1992 amendments to the HEA made substantial changes in the need analysis provisions of title IV, including simplification of the application form and processing, special provisions for the assessment of expected family contribution/financial need for both the poorest applicants and the middle class, and creation of a single need analysis formula for all title IV aid programs.

The amendments changed certain definitions and special conditions that had added to the length and complexity of the application form, the most important of which was the definition of an independent student. Students over age 24, married, or graduate students are now automatically considered independent, with determination of independent status for all other students left to financial aid administrator discretion. The Secretary is required to develop procedures for reapplication, so that aid recipients will not have to file the entire application each year even when their financial circumstances have not changed. In an effort to insure use of a free Federal application, the measure requires the use of a single Federal application form for which application processors would be paid by ED. To assist States in awarding their financial assistance, the 1992 amendments provide for the inclusion of not more than eight additional nonfinancial data items on the Federal form. Any additional financial data for State and or institutional aid has to be collected separately, for the processing of which contractors can only charge the marginal cost.

To deal with problems in the use of a simplified needs test originally enacted in the 1986 HEA amendments, but not widely used, the reauthorization legislation established a bypass provision so that those applicants eligible for the maximum earned income credit are automatically assessed as a zero expected family contribution without supplying further financial information; the simplified test is also retained, but the income cap was increased to $50,000.

As a gesture towards increased middle-class access, home and family farm equity are completely removed from consideration in determining a family's ability to pay for postsecondary education. The amendments also eliminated the current minimum student contribution that was required for all title IV aid programs except the Pell Grant program. Instituted primarily to decrease costs, some argued it unfairly penalized the poorest applicants.

The HEA as amended now provides for a single new need analysis formula to be used for the calculation of financial need for all title IV programs in place of the previous separate formulas for Pell Grants and the other aid programs. The new formula is based on the Congressional Methodology formula previously used for GSLs and campus-based aid. Because the resulting expected family contribution amounts would have varied significantly from the Pell Grant assessment schedules, adjustments to the formula were made to insure the minimum disruption in the distribution of Pell Grant recipients and award amounts. Despite these adjustments, some negative impact resulted, particularly for single childless independent recipients. The impact of reduced or eliminated Pell awards for these individuals was mitigated somewhat by continued eligibility for campus based aid and the ability to obtain new non need based unsubsidized Stafford loans (described below). The 1993 Technical Amendments also recognized this impact by providing that **subject to appropriations**, the students most affected could have Pell award amounts adjusted by financial aid administrators.

Pell Grant Program Changes

Although Congress was unable to agree on provisions to guarantee a significant increase in the Pell Grant maximum through entitlement or any other means, the 1992 amendments did make some major changes in the authorized maximum and the award rules for the Pell Grant program. The authorized maximum was increased to $3700 for the 1993-94 academic year, with increases in $200 increments up to $4500 in the 1997-98 academic year. The minimum grant was increased to $400 with students eligible for awards of $200 to $400 to receive $400.

Pell Grant award rules were also modified in 1992. Prior to the reauthorization, the amount a student received was the lesser of 60 percent of the cost of attendance, the cost of attendance minus the expected family contribution, or the maximum grant minus the expected family contribution. Because many argued that the 60 percent rule unfairly restricted the amount of the grant for the poorest students who attended the least expensive schools, the amendments eliminated this rule. Also, in a gesture towards tuition sensitivity (i.e., making the award level reflect differences in tuition charges at different institutions), the new award rules provide that when the maximum increases above $2,400, the additional amount will be split equally between a living allowance and tuition. (This is unlikely to have any real impact on recipient award levels in the foreseeable future.) In recognition of the needs of the growing number of nontraditional students, Pell Grant eligibility was also extended to less than half time students (such a provision was in the 1986 HEA Amendments, but was subsequently overturned by appropriations language).

GSL Program Changes

The 1992 reauthorization of the HEA (P.L. 102-325) made some major amendments to the GSL programs, including changing the name to the Federal Family Education Loan (FFEL) programs. Further changes were enacted in the OBRA 93 in connection with authorization of a new direct loan program (discussed below). The

amendments reflect some concerns raised during reauthorization: expanding the availability of loans, particularly to middle income students; promoting loan repayment; containing Federal program costs; and reducing defaults and encouraging loan program stability. As a result of anticipated savings from the phase-in to direct loans, a number of changes were enacted in the reconciliation act (P.L. 103-66) to reduce costs to students.

Unsubsidized Loans

Middle class access to loans was expanded under a new "unsubsidized" Stafford loan program. Unsubsidized loans are available to title IV-eligible students without regard to their financial need, under most of the same terms as Stafford loans **except** the Federal Government will not pay interest benefits. To offset Federal costs, the 1992 amendments required borrowers to pay a 6.5 percent loan origination/insurance fee, but no insurance fee could be charged by the guaranty agency. The 1993 reconciliation act changed the origination fee for unsubsidized loans to 3 percent.

Loan Limits

The 1992 amendments increased Stafford and the Supplemental Loans for Students (SLS) annual loan limits for students with at least 1 year of undergraduate education, with Stafford loan limits prorated down for programs of less than 1 academic year, and separate, significantly higher, SLS loan limits ($10,000 annual) for graduate students. Aggregate borrowing limits for Stafford and SLS loans were also increased. P.L. 103-66 combines the SLS program with the unsubsidized Stafford loan program on July 1, 1994. The newly established SLS loan limits are added to those otherwise available under the unsubsidized program for independent, graduate, and professional students.

The 1992 amendments also eliminated annual and aggregate borrowing limits under the PLUS (parent loan) program, effectively authorizing a parent of a dependent student to borrow up to the cost of attendance minus any aid the student receives from other sources. To be eligible for PLUS loans, however, parents are required not to have an adverse credit history.

Interest Rates and Fees

The 1992 amendments changed the fixed Stafford loan interest rates to a variable rate for new loans to first-time borrowers after October 1, 1992, to make such interest more responsive to market conditions. This annual rate, which was capped at 9 percent, is the U.S. Treasury bill (T-bill) rate plus 3.1 percent. The amendments lowered variable rates for SLS/PLUS loans made after October 1, 1992 to the T-bill plus 3.10 percent and lowered the caps on such loans to 11 percent on SLS and 10 percent on PLUS loans. To offset Federal costs, a 5 percent loan origination fee is to be charged on SLS and PLUS loans.

The budget reconciliation act included numerous provisions to reduce these interest rates and fees. For loans made on or after July 1, 1994, the cap on PLUS loans is reduced to 9 percent and the Stafford cap to 8.25 percent. For Stafford loans, both subsidized and unsubsidized, made on or after July 1, 1995, the in-school and grace period interest rates are reduced to the 91-day Treasury bill rate plus 2.5 percent. For loans made on or after July 1, 1998, the interest rates are changed again as follows with the "bond equivalent rate of the securities with a maturity comparable to the Treasury bond" as the base: Stafford loans, Treasury bond plus 1 percent, and PLUS loans, Treasury bond plus 2.1 percent. Effective July 1, 1994, the origination fee charged borrowers is reduced to 3 percent for Stafford and PLUS loans. The maximum loan insurance premium that may be charged by guarantors is also reduced from 3 percent to 1 percent.

Cost Saving and Risk Sharing

To reduce Federal program costs, the 1992 amendments lowered the special allowance (interest subsidy) rate paid lenders on new FFELs to the T-bill plus 3.1 percent. The reconciliation act passed in 1993 included numerous provisions designed to reduce Federal costs in the FFEL program either through reductions in Federal subsidies to program participants (lenders, guaranty agencies, secondary markets), new fees on these players, or increased risk sharing. These provisions include among others: a requirement that lenders pay the Secretary an origination fee equal to 0.50 percent of loan principal on loans for which the first disbursement was on or after October 1, 1993; a requirement that Sallie Mae pay the Secretary a monthly offset fee calculated on an annual basis of 0.30 percent of the principal amount of each part B loan held that was acquired after August 10, 1993; a reduction in the guaranty agency share of collections on defaulted loans from 30 percent to 27 percent; elimination of the 1 percent administrative cost allowance previously paid guaranty agencies; a reduction in the percent of reinsurance paid by the Secretary to guarantors on default claims from 100/90/80 percent to 98/88/78 percent depending on the level of default claims relative to volume in a given year; and a reduction in the insurance to lenders from 100 percent to 98 percent with some exceptions.

Repayment Options

To further enhance loan repayment, the 1992 amendments included a provision requiring lenders to offer graduated repayment schedules on all FFELs except PLUS loans to new borrowers on or after July 1, 1993. To simplify deferments, under which the borrower is temporarily relieved of repayment obligations and interest is paid by the Government for Stafford loans, the amendments consolidated the terms to a few basic reasons denoting economic disadvantage. New loan deferments effective July 1, 1993 on loans to new borrowers only, include the following: an in-school deferment similar to previous law with no time limitation; up to 3 years for unemployment; and up to 3 years for economic hardship, as determined by the Secretary of Education primarily considering the borrower's income and debt to income ratio, but also to include all borrowers working full-time but earning not to exceed the minimum wage or a wage equal to 100 percent of the poverty level for a

family of 2. Lenders are also required to grant forbearance for up to 3 years if a borrower's debt burden equals at least 20 percent of his or her income, in addition to requiring forbearance for borrowers during the pendency of their medical residencies and internships. The amendments also contained a provision authorizing the discharge of borrower debt in situations of school closure or false certification of students for loans, effective retroactively on loans made on or after January 1, 1986.

Consolidation Loans

Although the 1992 amendments increased the minimum balance for loan consolidation to $7,500, this provision was eliminated in reconciliation. The repayment period for such loans was extended to a maximum of 30 years, with Federal interest benefits provided during deferment. The amendments in the reconciliation act clarified that the Secretary will make such payments only when the entire consolidation loan is made up of subsidized Stafford loans; otherwise, interest must be paid by the borrower or capitalized. P.L. 103-66 also changed the interest rate for consolidation loans effective July 1, 1994 to the weighted average of the loans being consolidated; before then, a minimum 9 percent rate applies. All lenders are required to offer income sensitive repayment terms to borrowers of consolidation loans made on or after July 1, 1994.

Repayment Demonstrations

The 1992 amendments also included provisions authorizing demonstration activities to encourage repayment. The Secretary of Education is authorized to provide income-contingent repayment for up to 25 years for certain high risk borrowers and certain defaulters if he or she determines that this repayment mechanism will increase loan collections. A small demonstration program forgiving FFEL debt for employment in some teaching, nursing, and volunteer jobs was also included, although funding was changed to a separate authorization rather than being part of the FFEL funds. The Secretary is also authorized to establish programs to encourage employers to help their employees repay student loans.

Direct Loans

One of the most significant recent issues has been "direct loans"--changing the policy of having loans capitalized by private lenders and guaranteed against default by the Federal Government to one under which the Federal Government provides the loan capital, owns the note, and absorbs defaults as part of its costs. Considerable debate took place over this concept during reauthorization and the 1992 HEA amendments established a direct loan demonstration program to be conducted between July 1, 1994 and June 30, 1998 at schools with FFEL program (Stafford, SLS and PLUS) loan volume totaling $500 million. However, in 1993, the Clinton Administration proposed legislation to totally replace the guaranteed student loan programs with direct loans. The following describes the major provisions of the legislation to phase in direct loans adopted in title IV of P.L. 103-66, OBRA 93, signed by President Clinton on August 10, 1993.

Phase-in to Direct Loans

Under the new law, the Secretary of Education will select schools to participate in the direct loan program so that loans at such schools will constitute 5 percent of new student loan volume in academic year 1994-1995, 40 percent in academic year 1995-1996, 50 percent in academic year 1996-1997, 50 percent in academic year 1997-1998, and 60 percent in academic year 1998-1999. Beginning in the 1996-1997 academic year, the Secretary may exceed the specified percentage for direct loans if he or she determines it is warranted by the number of eligible schools wishing to participate.

Schools apply to participate in the direct loan program and the Secretary choses participants among them. Institutional eligibility requirements are similar to those for guaranteed loans including ineligibility due to high defaults. Schools selected to participate in the direct loan program are required to be reasonably representative of all schools by certain characteristics such as loan volume, length of academic program, control of institution, geographic location and default experience. On November 15, 1993, the Secretary of ED announced the first 105 schools selected to offer direct loans during the 1994-1995 academic year to approximately 300,000 students accounting for 5 percent of new loan volume nationally.

Loan Eligibility, Characteristics, and Terms

The new law provides that students and parents are entitled to loans for the student's attendance at a participating school, but schools will specifically not have a right to program participation. Participating schools will, however, be authorized to refuse to certify a student's eligibility for a loan in exceptional circumstances. Loan terms and conditions for direct student loans, called Federal Direct Stafford Loans (FDSL) and Federal Direct Unsubsidized Stafford Loans (FDUSL), as well as direct PLUS loans are basically the same as guaranteed loans as amended and described above. Schools participating in the direct loan program can also be authorized to continue to participate in the guaranteed loan program at the discretion of the Secretary, but borrowers are only eligible to receive either a guaranteed or direct loan for a given period of enrollment.

Repayment

A major aspect of the direct loan program provides different types of repayment plans for direct loan borrowers. The Secretary must offer four alternatives: standard, under which there would be fixed payments over a fixed period of time; an extended repayment plan, with fixed payments over a longer than standard period but meeting the $50 monthly payment minimum of current law; a graduated repayment plan, under which the borrower would pay at two or more graduated levels under a typical or extended repayment period; and an income contingent repayment plan, under which students annually would repay an amount reflecting a proportion of their annual adjusted gross income for a period determined by the Secretary up to 25 years (income contingent repayment would not be available to PLUS loans borrowers). If

the borrower does not chose a repayment plan, the Secretary is authorized to select one on his or her behalf, but may not select income contingent repayment. Also, another alternative for repayment may be provided by the Secretary to accommodate a borrower's unique circumstances. Defaulted borrowers of direct or guaranteed loans may also be required to repay through an income contingent plan.

Direct loan borrowers are authorized to consolidate their loans with guaranteed and other loans eligible for consolidation under the current Federal Consolidation loan program under terms and conditions established by the Secretary beginning in the 1995-1996 academic year. With regard to Federal Consolidation loans, eligible borrowers are authorized to obtain direct consolidation loans from the Secretary if the borrower is unable to obtain a consolidation loan from a lender or obtain such a loan with income sensitive repayment terms acceptable to the borrower. Such loans would, in addition to the existing repayment terms available to consolidation loan borrowers, be eligible for income contingent repayment terms.

Administrative Costs

Under the new law, funds for Federal administrative costs (program operations by ED, servicing contracts etc.) for direct loans are mandatory spending with a permanent appropriation. Such costs for Federal credit programs are customarily discretionary. Maximum spending for administrative costs, which have specific annual authorizations under P.L. 103-66, over a 5-year period (FY 1994-FY 1998) are $2.5 billion.

Early Intervention

Congressional concern about the access of disadvantaged and minority students to postsecondary education is reflected in the 1992 reauthorization legislation in various ways, including the continuation and expansion of Federal student aid programs and the TRIO programs under title IV--Student Assistance; programs for colleges serving low-income and minority students under title III--Institutional Aid; and programs addressing minority access to, and progress through, graduate and professional school under title IX--Graduate Programs. Perhaps of most interest have been proposals for new early intervention initiatives based on a model that merges a guarantee of financial assistance to meet postsecondary education costs with early knowledge about postsecondary opportunities and a system of guidance, mentoring, and support services to help disadvantaged youth finish high school.

The 1992 HEA amendments enacted an early intervention program, entitled the National Early Intervention Scholarship and Partnership Program, that provides early intervention services and postsecondary student aid to persons who had participated in early intervention activities or in the TRIO programs. States are required to match Federal assistance. At least 25 percent of the program's funds but not more than 50 percent have to be focused on outreach and support services. The 50 percent cap can be waived for States able to demonstrate alternative sources of funding to meet participants' financial aid needs. Selection priority in the State early intervention

efforts is to be focused on low-income persons. Among the services provided to participants are mentoring, counseling, after-school and summer tutoring, and assistance in obtaining summer employment. The amendments set the minimum level of postsecondary financial aid at the lesser of 75 percent of each State's average in state cost of attendance at 4-year public institutions of higher education or the maximum funded Pell Grant in that year.

In addition, the amendments provide for the Presidential Access Scholarships which will be available to students completing a college preparatory course of study, having a grade point average of 2.5 or higher in the last 2 years of high school, and either having graduated in the top 10 percent of their high school class *or* having participated in an early intervention program. Recipients must also be eligible for a Pell Grant in the year of their award. Awards are to be the greater of $400 or 25 percent of each student's Pell Grant.

A Model Program Community Partnership and Counseling Grant program to support model programs of effective early intervention was established, as well as authorized funding for a computerized database of all public and private financial aid programs, and a new public promotion program targeted to groups, such as economically disadvantaged students, minority students, and students with limited English proficiency. The latter program is to promote the availability of Federal student aid funds and the importance of pursuing postsecondary education.

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